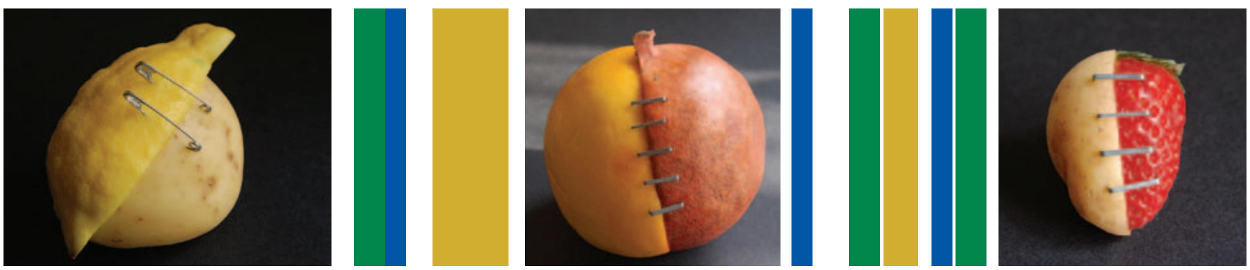
Culture Management in M&As



It is critical to focus on culture and people to make integration strategies work.

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In management's rush to "do the deal", costly mistakes can surface long after final papers have been signed. With forethought, common pitfalls can be avoided.

The following notes reflect the contents of a recent speech where I was asked by the organisers to address the audience on the topic of managing cultural issues of transition in M&A and joint venture situations with respect to often-declining productivity, performance and morale during times of change. I stressed the importance of an integration plan that addresses cultural factors head-on, as they can be deal killers, no mater how carefully the financial and operational aspects of the deal are managed, and management of the dynamics of people involved in the process.

Participants confirmed, all too often, management in the acquiring company is not prepared to deal with the post-merger dynamics that can lead to reduced productivity or the loss of valuable personnel. Underestimation and/or lack of any consideration of the culture integration challenges and the impact from varying leadership styles are just two examples of drivers that can erode expected "deal value". The resulting loss of customers and revenues can negate the anticipated benefits of the consolidated organisation.

Framing Our Discussion

Traditionally, the legal, financial and operational aspects of M&A deals and joint ventures have received the greatest attention, but executives who have been through the merger process are recognising that managing the cultural and human side of change is critical to maximising deal value.

Scanning the news, one notices that hardly a day passes without the announcement of one or more high profile amalgamations. In short, they seem to be contagious, and the current epidemic is not restricted to the large American and UK based institutions that consistently make front-page headlines. Globally, the merger bug has bitten both private and public sector organisations of all sizes. However, regardless of the size or the finances of the companies, the rush to "do the deal" can result in costly mistakes that can surface months after the final papers have been signed.

The prevailing view in Europe and beyond is that "scale is important", that in the global marketplace bigger is better. Companies have various strategic options available to them in order to achieve their growth objectives and to compete effectively in the global marketplace. The first key decision is whether to grow incrementally or to take a giant step or leap. One of the incremental options available is to introduce new products or services. Enhancing existing services to grow top-line revenue and entry into new markets are two other possibilities. If the enterprise prefers to take bigger steps in terms of growth (the 'leap' approach), M&A is perhaps the quickest way to increase presence in the marketplace.

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Regardless of the growth strategy chosen, success will be measured not by what you do to grow but by how well you do it. While the potential impact of a major merger or acquisition has likely lead to its appeal as a growth strategy in the 1980s, 90's, and first half of this decade, M&A is also the riskiest proposition an organisation can undertake to achieve its growth objectives. There is compelling evidence to suggest that growth through M&A is not, in and of itself, a guarantee of success. Recently published surveys indicate that, on the contrary, most deals fail to deliver their promised returns.

Does Culture Matter in M&As?

You bet! "cultural and people" issues have been cited as the most common failure factors in six major studies. The research has shown that 70% of mergers and acquisitions fail to achieve the anticipated "synergies" while 50% suffer an overall drop-off in productivity in the first four to eight months. "People problems" were cited as the top integration failure factor by a sample of 45 CFOs from Fortune 500 companies which have merged/acquired.

The stock market has also become merciless in its treatment of M&As. When a merger or acquisition is announced, the value of the acquired company's stock will increase. But the same cannot always be said for the stock value of the acquiring organisation, which rises in only 30% of M&As. Analysts and investors expect the merged enterprise to be greater than the sum of its part – in essence that one plus one will equal three. These same analysts and investors are content to sit on the sidelines and wait for management to deliver the synergies that will be essential for the deal to be a financial success. It is these projected synergies that are the real "value" of the deal.

Maximising Deal Value

We can see that the 'deal flow' in M&A can be viewed as a chain with five distinct links:

The "formulate", "locate" and "investigate" stages occur before the deal is made and are referred to collectively as the "pre-deal" phase. During these stages, the acquiring company sets out its growth objectives and its acquisition strategy. Target companies are identified and assessed for potential fit with the growth objectives and the due diligence is conducted. The goal during the pre-deal phase is to forecast, as accurately as possible, the potential value in terms of both financial and human capital that could be realised if the deal is consummated.

As the organisation moves through the pre-deal phase, the due diligence becomes a particularly important task. Due diligence should be considered from two dimensions. The first is financial, and this is where the "deal breakers" are most likely to arise. In terms of human resources, this perspective includes such matters as the funding of pension plans, plan structures and risks and liabilities that may be associated with workers compensation, collective agreement provisions and employment-related litigation. Differing legal, accounting and reporting practices that exist from country to country have increased the complexity of conducting thorough financial due diligence. Inaccurate estimates of financial liabilities for such items as pensions or retiree medical benefits can potentially eliminate any financial gain from the transaction.

Due diligence should also be undertaken in a second dimension - the "human capital" perspective, which if neglected during the pre-deal phase will minimise the value of the deal. During human capital due diligence, the acquirer should seek to identify commonalties and differences in such areas as partner/target company culture, leadership models, organisation structure, performance management systems and workforce development approaches. While it is unlikely that human capital due diligence will unearth "deal breakers", it will provide the acquirer with critical insight into the potential cost of realising deal value. Particularly in situations where a high degree of integration is desired, a thorough human capital due diligence will allow both partners to properly assess the true cost of achieving that integration.

Although due diligence should be a mechanical exercise we often find that the emotion and momentum of the deal often hides good due diligence. Thus while in the "negotiate" stage, lawyers, investment bankers and various other advisers representing the acquirer and the target meet to make the deal – often their council with regards to areas of risk are ignored by key decision makers. In essence, what the parties are doing is agreeing on the potential value while at time ignoring some of the key data. Once the deal has been concluded and the value, in terms of hard assets and intellectual capital, identified and agreed to, the focus shifts to the various functions within the two organisations - operations, finance, marketing, sales and human resources to make the deal happen.

It is in the post deal integration phase that the perceived value of a merger or acquisition will either be realised or not. Unfortunately, for many companies it is also in this phase that the deal fails because the parties focus too much on the financial aspects of the merger or acquisition without adequately addressing the people components that must be considered to forge two or more organisations into one cohesive entity. One way to meet the challenge of maximising deal value is to embrace the integration process as a far-reaching change management initiative for both companies. Enterprise-wide integration is a change management methodology applied with speed and rigor simultaneously to all functional departments and business units in a merger. It relies on disciplined project management, process consulting and tactical problem-solving to achieve a fast and effective merging of the business processes, systems and organisational issues. A single infrastructure is used to co-ordinate all integration efforts and communications across the combined companies.

A disciplined, enterprise-wide approach to integration helps organisations maximise deal value by lowering deal costs, facilitating faster integration and a smoother transition and achieving projected synergies sooner. Potential benefits of an enterprise-wide approach to merger integration typically focus on generating the following results:

- **Achieving deal synergies promised to investors;**
- **Merging both organisations and their respective business processes as fast as possible;**
- **Ensuring the retention of key talent and customers;**
- **Avoiding the costly mistakes that can occur in merger integration;**
- **Communicating strategically with all managers and employees; and**
- **Measuring operating results and employee perceptions on an ongoing basis**

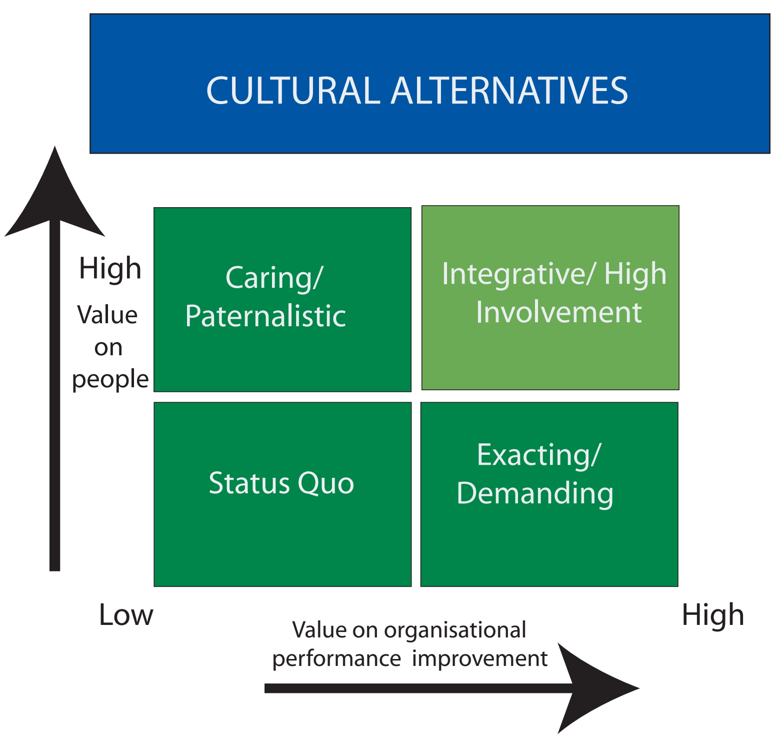
From the outset, an aggressive merger integration timeline typically needs to be created covering three distinct integration phases;

1 **The "pre-deal" phase (before the announcement of the merger)**
2 **The "deal" phase (within 60 days after the deal is closed) and**
3 **The "integration" phase (subsequent to the first 60 days).**

What are we trying to achieve in integration?

The goal is to gain support from one hundred percent of the task force leaders and officers to champion the integration process and exceed expectations. During the transition, having employees stay focused on running the business and customers continuing to receive seamless service will be a result of the degree to which timely communications address employee's issues about their own position in the "new" organisation. While it will be too soon to determine if all of the long-term objectives of the merger will be met, the speed of integration will help to capture estimated pre-consolidation synergies and keep the new company on track to achieve first-year financial objectives.

Although much of the change leader's role will involve details of integrating tactical components of the integration structure and plan, we strongly recommend the desired culture, vision and values to be reflected in all decisions and communications. The following strategic framework outlines some alternatives in identifying a desired future culture:



CULTURAL FOCUS

One (low/high) - Family-oriented - Effort and activity is rewarded - "Fitting in" is important - slow to change - Trusting environment	Four (high/high) - Foster co-operation, risk taking and group performance - True learning organisation - Strong communications feedback _"Transparent Management" - Team oriented
Two (low/low) - "We have always done it that way - Seniority rules - Procedures are important - "Play by the rules"	Three (high/low) - Emphasis on bottom line - "Eat what you kill" - Focus on efficiency, competition, individual performance - "Up or out" - learning environment

Throughout the transition from one culture to another, we find that if organisations cannot be explicit about how they want their culture to be aligned with their commercial strategy then conflicts and confusing messages are continuously sent to both their employees and their customers. This matrix reflects the questions that are typically asked (or should be asked) of leaders in aligning their change plans. To what degree has the commercial strategy been clearly defined to allow for the clarification of the cultural strategy to guide your integration? We believe that clarification of your desired culture, along with clear measurement, provides a guide for integration, performance management strategies and other culturally-related imperatives.

Below we outline brief examples of the implications of reinforcing one culture or another:

Caring Paternalistic: Family oriented effort and activity is rewarded, "fitting in" is important – typically slow to change, and trusting environment

Exacting/Demanding: Emphasis on bottom line, eat what you kill, focus on efficiency, competition, and individual performance, up or out learning environment

Apathetic: Often reflects the status quo and provides comments such as, "we have always done it that way, seniority wins, procedures are important and play by the rules".

Integrative/High involvement: Foster co-operation, risk-taking and group performance, true learning organisation, strong communications/feedback, open book, team oriented

Now that we have defined the culture, what next?

Don't be fooled - the move to a new culture is a not simply a new programme, new set of reports, or new training – it is most often a significant change initiative fraught with all the perils of workplace change.

Once the organisation knows what it wants to be then aligning its systems, processes, and procedures to reinforce the desired culture is critical. These mechanical adjustments are the easy part. The difficult part is aligning the employees and leadership team with the new culture.

Secure Individual Buy-In From Leaders

To be effectively implemented, integration strategies must first be consistently understood and owned by the leaders. Experience indicates that this is often not the case in the immediate post-integration period. To succeed, leaders must have a vehicle for articulating their basic assumptions, expectations and values - and therefore consciously assess what they need to change personally before engaging others in the organisation. We have found that, similar to the process of defining a new culture and climate for the organisation, the process of aligning leaders with a new strategy and culture works best if a step by step approach is taken:

Interpretation: The degree of cohesion between each team member's unique interpretation of the desired culture, climate and post integration strategy. Leaders must understand the pressing commercial "business case" for change.

Acceptance: The degree to which individuals accept the integration change plan as the "best" one under the circumstances will highly influence the success of implementation.

Commitment: The degree to which the leaders accept the strategic and cultural change goals as being in line with their personal goals will be a function of the degree to which they perceive the change to be a personal threat or an opportunity for development.

Competence: The competence of the organisation and associates, in terms of skills, abilities, systems and infrastructure, to achieve the changes required to make the culture and integration strategy work will provide barriers or enablers for successful implementation.

Successful change can be attributed, at least in part, to the early realisation that the merger integration needs to be managed as a fully co-ordinated plan including:

- An early start
- A timetable aimed at speedy completion
- Decisive leadership
- Clear and frequent communications to both organisations and
- Focus on customer service and the willingness to make decisions on the toughest issues.

The stakes are high whenever mergers and acquisitions take place. Experience demonstrates how a well-managed, enterprise-wide integration process that recognises change management concepts can significantly enhance the launch of a newly amalgamated organisation.

Addressing the "me" issues

One of the most critical priorities for management of merging organisations to address is the "me" issues. Throughout M&As, "me" issues will preoccupy employees at all levels within both organisations. Typical "me" issues will include:

- Will I have a job?
- Will my pay and benefits change?
- What will happen to my pension plan?
- Who will I report to?
- Will I have to move?
- What will 'they' be like to work for?

Employee concern about "me" issues creates an inward focus away from customers. Service suffers as a consequence and employee productivity drops off. The new enterprise could also lose key talent as employees search for an environment with less uncertainty, an outcome that would be particularly grave for an organisation that was buying specific knowledge or competence as a goal of the acquisition.

Because senior management's "me" issues will usually be answered before the majority of employees, they must be conscious to manage from where the organisation 'is', and not from where 'they are' as a management team. Senior management must guard against the temptation to concentrate on the "next deal" while employees think of issues posed by the current deal. Management can influence how long the productivity drop, as a function of the change management process and the speed with which it is applied. Prolonging the integration process will only serve to extend the drop in productivity and delay the realisation of deal value.

Integration risk factors

To increase the probability of a successful merger or acquisition we have worked with Prof. Tim Galpin (University of Dallas) in the past to identify 12 integration risk factors that should be taken into account from the outset of planning by senior management. The nature of the risk and the extent to which each applies will vary from deal to deal. This leads to the need to assess each risk factor on a deal-by-deal basis. Where possible, a mitigation strategy should also be developed to help the enterprise manage the risk. We have framed these risk factors in the form of questions that may be on the minds of investors, analysts or stakeholders in the process.

Desired integration level To what extent will the organisation be integrated? Full integration can increase the complexity of the deal and the associated risk

Management talent Does the management team have the necessary talent to lead the new enterprise through the integration?

Strategic non-alignment To what degree will organisations that are not strategically aligned be integrated and how will the integration effort affect the level of risk?

Financial context/business performance What degree of confidence do you have that you can turn around a struggling target? How long will it take?

Pre-deal positioning What potential synergies were identified to legitimise the deal, and why was the deal initiated in the first place?

Proximity Are the organisations in different geographical regions? If so, to what extent will the legal, language and cultural differences associated with integrating organisations from different geographical areas lead to increased risk?

Competition What is the nature of the competition your company faces? Organisations operating in highly competitive markets will be under increased pressure to achieve deal synergies. Competitors will move quickly to fill the gap created by organisations in pause.

Relative dominance One of the myths within M&A is the "merger of equals". Have the organisations been honest internally? The extent to which this remains unresolved will contribute to increasing risk.

M&A capability What is your experience with M&A? The extent to which the enterprise is experienced with M&A will serve to mitigate risk.

Ambiguity in power and authority Who is "in charge?" Is your company building M&A as a core competency? The integration process must be driven internally as a priority for senior management. The appointment of an experienced and respected manager to lead the integration process is a key to mitigating risk.

Concurrent pressures To what degree is the organisation facing other internal or external pressure. There is a limit to the number of fires that management can reasonably be expected to fight successfully at any one time.

Hostility quotient What are the circumstances surrounding the merger? Generally, as the degree of hostility toward the acquiring organisation increases, so will the risk.

Senior management will want to both assess and continually review the issues around each of these risk factors. We have found it helpful to group the issues in terms of what can be done immediately. The advantage of using an approach to M&A like enterprise-wide integration is the actions designed to mitigate risk can be incorporated into project planning and monitored on a company-wide basis throughout the integration process.

The 7 deadly sins of M&A's

While there are undoubtedly other roads to success in mergers and acquisitions, there are a few "sins", which, f committed, will ensure that your deal will fail. We refer to these as the "7 deadly sins of M&A."

1 **Poor due diligence -** this would include both financial and human capital due diligence. The former will result in money being left on the table. The latter will lead to unanticipated integration costs.

2 **Delay the start of the integration and drag out the finish.** The longer integration is allowed to drag our and issues are left unresolved, the longer productivity will suffer and the longer it will take for synergies to be realised.

3 **Allow divergent initiatives -** integration can be viewed as a race, where the objective is to have everyone cross the finish line together. By allowing divergent initiatives, you will delay crossing that line.

4 **Take too long to answer the "me" issues -** remember that in an M&A situation, you should expect a drop in productivity while employees search for answers to the issues that are important to them. Both the duration and the magnitude of the drop are within your control.

5 **Under communicate -** during an M&A, people's desire to "know" increases. If you under communicate, you will effectively create an information void that will be quickly filled with rumour and innuendo.

6 **Put no one in charge -** like many sports teams, the M&A team needs a "go to person" that can make things happen. The project leader must be someone who is respected in the organisation and who has the authority to make decisions.

7 **Ignore project management disciplines -** this is perhaps the deadliest sin of all. Your organisation is about to embark on a major project with another company whom you don't even know. Disciplined project management is the only way to ensure that you can plan, monitor and measure your progress toward achieving the goals you set at the beginning of the process.

Key success factors

If we are not tempted by the 7 deadly sins, we need to maintain total project integrity and rigor and embrace the following 10 key M&A success factors, to ensure deal value is maximised.

1 **Thorough due diligence** - both financial and human capital. What-ever happens at due diligence will impede or facilitate the post-deal activities – ensure you have a sceptic on your team.

2 **Vision of degree of integration** - the degree dictates the complexity and its associated risks

3 **Speed of decision making** - this is not the occasion for precision

4 **Senior management alignment** - visible support and commitment is mandatory

5 **Clearly defined approach** - everyone who needs to know, knows

6 **A respected and capable integration leader** - this is not the time to earn stripes; this is the time to use them

7 **Dedicated and capable merger team** - team and task members need to be responsive and focused

8 **Use of best practices** - use the best of what is there

9 **Measurable goals and objectives** - clear and achievable deliverables are a must

10 **Ongoing communication** - open and frank two-way communication is an imperative

The goal of the discussion was not to provide the attendees with "all of the answers" for succeeding in the M&A arena. The intention was more to focus beyond the act of making the deal to the point where the real value of the deal is realised and to provide our thoughts around maximising deal value.

A recent survey of mergers and acquisitions identifies that cultural incompatibility is the biggest problem facing leaders, yet the leaders rated organisational culture and the dynamics of change last in the type of due diligence needed for success. We also know that the time to make change is limited, the way cultural integration is handled will make the difference between success and failure of the deal, and that delaying the start and dragging out the finish is the worst of the deadly sins. These key leanings of our discussion are nicely summarised by Percy Barnevik, CEO of ABB:

"Why emphasise speed over precision?

Because the costs of delay exceed the costs of mistakes."

ABOUT THE AUTHOR

Douglas Ross is Managing Director of Square Peg International and specialises in areas related to the people side of change focusing on mergers, acquisitions, joint ventures and cultural alignment. He retired his partnership in Watson Wyatt's Human Capital Group in 2004 after a decade supporting clients in 20 different countries, many in the throws of post merger integration.

He is known for his dynamic and practical consulting approach that has evolved during an unusual career spanning CEO, theatre producer, soldier, and manufacturing manager. He has been honoured by the Canadian Government for his leadership work and in December 2002 was recognised by the Independent Newspaper as one of the top 10 management consultants in the UK.

His practical experience in M&A, JV, and organisational change combined with his credentials as an MBA, Certified Management Consultant (CMC), Visiting Fellow at Kingston University and past Associate Professor of Marketing Strategy at the Canadian School of Management, and position as past global Chairman of the Strategic Leadership Forum commend him to support clients to align their people practices and processes with their merger strategies.

ABOUT SQUARE PEG INTERNATIONAL LTD.

Square Peg is an international boutique consulting practice that provides an integrating force in the alignment and effectiveness of organisations. Our services are based on the interrelationship between business strategy, leadership and people - our focus is to help clients improve performance and drive value.

As business consultants focused on the people side of change we support clients managing a variety of enterprise-wide changes such as M&A's, establishing new mandates, and meeting new expectations.

We maximise productivity, performance and morale and drive value by accelerating results, ensuring their quality, and measuring their impact. From our offices in the UK and North America we assist companies to capture the full value of their investment in people.

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We know that the best consulting services are an investment – not a cost. Square Peg strives to deliver the best return on your investment. We can help your organisation achieve organisational excellence.